

The Arbitrator's Role in the Application of Mandatory Rules and Conflict of Law Rules in International Commercial Arbitration

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1 Introduction

1.1 General

Contrary to national courts which are based on the legislative system of their respective state, an international commercial arbitration has no such foundation. It is, in simple terms, based on the will of the parties. By adding a clause to the contract negotiated between them, the parties may agree that any dispute arising out of or in connection with the present contract, shall be solved through arbitration. By that particular clause the parties then exclude the jurisdiction of ordinary courts and make their dispute subject to arbitration instead. There are several advantages in choosing arbitration as a dispute resolution. The parties are faced with a neutral tribunal that consists of one or three private individuals possibly chosen by them, which in turn will render a binding award upon the parties. As a consequence of being a private resolution forum, arbitration is depended upon the parties respecting the final decision of the tribunal. Should any of the parties refrain from accepting the award, it would have to be recognized and enforced with a national court to be legally binding upon the parties. Accordingly, this establishes a dependency on national courts which might impose obligations on arbitrators when conducting an arbitration. The enforceability of the award is ensured through the New York Convention of 1958 which have been ratified by a numerous amount of states.¹ In comparison, foreign judicial decisions do not enjoy the same uniform treatment.

Another significant reason for submitting a dispute to arbitration is that the parties are free to choose the governing law of the substantive matters of the dispute. This freedom is a part

¹ United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958). Art 3 states: “ Each Contracting State shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the awards is relied upon, under the conditions laid down in the following articles.”

of the well known principle on party autonomy which is generally recognised in the vast majority of the states dealing with commercial matters. As an example; section 3 of the Norwegian Act on the Law Applicable to International Sale of Goods of 1964 expressly provides for the freedom of choice by the parties.² Article 3 of The Rome Convention which constitutes the private international law of all member states in the European Union, also recognizes this principle.³ The first sentence states that:

“A contract shall be governed by the law chosen by the parties.”

As a direct link to arbitration, article 28 of the UNCITRAL Model Law first point, first sentence provides that *“The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute.”*⁴

When negotiating an arbitration clause, the parties enjoy a large freedom in choosing which law should govern the merits of a possible dispute. This is due to the extensive freedom entrusted the parties in deciding upon the terms of the contract as a whole. Consequently, neither the choice of governing law in case of a dispute should be subject to any limitations. The parties may choose to have their dispute governed by e.g. national or international rules of law, general principles of law, or they might entrust the arbitrators to act as *amiable compositeurs*.⁵

When the parties have made an explicit choice on substantive law, the arbitrators are obligated to apply that particular choice of law, but to what extent are they obligated to abide the will of the parties in its entirety? Put in another way; may arbitrators limit the party autonomy by applying mandatory rules? As all of the previous mentioned rules provides for the recognition of the principle on party autonomy, none of them regulates the

² Kjøpsvalgsloven av 3.april. Nr 1, 1964, section 3, 1st sentence.

³ EC Convention on the Law Applicable to Contractual Obligations (1980)

⁴ UNCITRAL Model Law on International Commercial Arbitration (1985)

⁵ *Amiable compositeurs*; Enables the arbitrators to solve the dispute in accordance with fairness and notions of justice without having to rely on any rules in particular.

scope of the principle. While national courts are forums of national legislation and thus forced to respect the rules regulating the application of mandatory rules and public policy of their respective states, arbitral tribunals are not constituted by the laws of the seat of the arbitration and thus not required to show such strict allegiance. The latter indicates that arbitrators may be restrictive in the application of mandatory rules. However, this does not seem to be accepted as a main view. Besides a few supporters of the absolute free will of the parties, most scholars and practitioners of international commercial arbitration maintain that party autonomy is, at least to some extent, limited by mandatory rules.⁶ This means that, like its domestic counterpart, the arbitrator might be required to apply mandatory rules in addition to the substantive law.

In connection to the above discussed, there might be circumstances where the parties have failed to make such choice on substantive governing law. The arbitrators are then faced with the task of finding the suitable governing law. The answer cannot always be sought through the party autonomy alone, so in order to determine the governing law, the arbitrators must turn to the applicable conflict of law rules. As it appears, there are several possible options towards reaching the law most suitable to solve the dispute between the parties.

As seen in this introduction, the conduct of arbitration involves an interaction of a various set of rules in which the arbitrators play a very important role.

⁶ See for example: Chukwumerije *Choice of Law in International Commercial Arbitration* (1994), p. 183, Cordero Moss *International Commercial Arbitration* (1999), p. 402, Lazareff *Mandatory Extraterritorial Application of National Law Rules* (1996) p. 555

1.2 Delimitations

International commercial arbitration involves several systems of law. It is possible to identify at least five different systems which may affect the conduct of the arbitration.⁷

These are:

1. The law governing the capacity to enter into an arbitration agreement
2. The law governing the agreement and the performance of the agreement as such
3. The law governing the existence and proceedings of the arbitral tribunal
4. The law governing the recognition and enforcement of the award
5. The law governing the substantive issues of the dispute.

Due to the complex of each system and the extent of this thesis, there will not be room or time to evaluate them all. Point 1 until 4 will therefore not be discussed in relation to this thesis, even if they equally represent an individual and conclusive part of the conduct of arbitration. Instead, I will concentrate on point 5 which in turn is the main representative of the principle on party autonomy in international commercial arbitration.

In relation to the choice on substantive law, the parties will be faced with different opportunities as to which legislation should govern their dispute. The choice on governing law by the parties itself will not be subject to a detailed treatment. This will only briefly be mentioned. The focus will lay on the mandatory rules connected to the choice and the rules connected to the absence of such.

⁷ Redfern and Hunter, *Law and Practice of International Commercial Arbitration*, (2004), p 91

1.3 Topic and Problem Identification

International commercial arbitration is in first hand conducted through the will of the parties due to the principle on party autonomy. But to the extent the party autonomy is bound by limitations, the participation of the arbitrator to the conduction of the arbitration is of great importance. To what extent may the arbitrator limit the will of the parties and hereunder the party autonomy? The role of the arbitrator in connection to the choice on substantive governing law will be the topic of this thesis. The aim will be to try to make an overview of possible approaches invoked by arbitrators when (or if) applying mandatory rules in addition to the legislation expressly chosen by the parties, and in the absence of such, the rules applied in their place.

The first of the two aims of the topic is the application of mandatory rules in addition to the substantive law and leads to the following question:

When the parties have made an express choice on governing law; under which circumstances will the arbitrator be respective towards applying mandatory rules, and thus restrict the party autonomy? Hereunder, are there any requirements for applying such mandatory rules and is it possible to identify different approaches towards the application?

In those situations where the parties have failed to reach an agreement on the governing law, the arbitrator plays the important role of deciding which law would govern the dispute. In regards to the content of the conflict of law rules, it varies from different legal systems both national and international. As a severe number of arbitrations are preceded through institutions, conflict of law rules might be determined according to rules connected to such institutions as well. Identifying the different approaches by the arbitrators and the most commonly applied rules will be the second main topic of this thesis and leads to the following question:

When the parties have not made an express choice on governing law, what are the different approaches followed by the tribunal in determining the issues raised by the parties?

Hereunder, what is the scope of the arbitrator's freedom in applying the substantive law to govern the dispute? And is it possible to detect any new trends of application today?

1.4 Method and Disposition

The implementation of international commercial arbitration is characterized by the dualism of national and international laws or rules of law applicable to the substance. Especially, the application of national laws makes it difficult to locate a general pattern with arbitrators carrying out the arbitration. A complete overview on the national rules related to the substantive matters on international commercial arbitration will therefore not only reach beyond the scope of this thesis, but also be an almost impossible task. Thus, in relation to the problems identified above, international conventions will be applied in addition to Norwegian and Swiss Law. Where international conventions, such as the Rome I Regulation or the Rome Convention, are not regulating Norwegian law, Swedish law will be applied. Where it is needed, by means of highlighting certain issues, other national laws will be applied as well. However, the international aspect of this presentation requires that most effect is given to international laws and rules of law.

In order to emphasize the approaches taken by arbitrators in practice, one would have to make use of arbitration awards. Due to the principle of confidentiality in arbitration, a majority of the awards are not made public which will make it difficult to present accurate and practical examples in certain situations. Nevertheless, some awards or interim awards are made public, and the relevant ones will be applied to support and indicate traditions or trends to the problems discussed below. The main part of the awards is rendered by the ICC, but a few awards rendered by the SCC will be used as well.

When examining the issues underneath, particular authors will be mentioned expressly in the text. This approach is more commonly used in an international context, but it is useful as means of highlighting the underlying arguments and possible disparities in the different theories and approaches that will be discussed. The overall aim in using this method is to be able to present a more complete picture on particular topics. This method is above all used in part 2.5 of this presentation, due to the uncertainty surrounding the question of applicable foreign mandatory rules, but it will also be used in connection to other parts of the text.

Part 1, chapter 2 will analyse the content of mandatory rules which might be overriding the parties' choice on governing law. Therein after, the different circumstances under which an overriding mandatory rule might be applied will be presented and discussed.

Part 2, chapter 3 will discuss the consequences of the failure by the parties to agree on substantive law, under which several approaches taken on by the arbitrators will be presented.

Part 2, chapter 4 will discuss the choice of substantive law itself, hereunder the extent of the arbitrators freedom, and the impact of the UNIDROIT Principles and general principles on the private international law.

Chapter 5 will consist of conclusions regarding the issues raised in this text.

PART I

2 Choice on Substantive Law and the Implication of Mandatory Rules

2.1 General

There lie a few considerations in the question of the circumstances to which an arbitrator might or would be willing to apply mandatory rules of law. When the parties have made an express choice of law, the arbitrators are, by all, required to respect such choice. This is part of the tribunal's obligation to stay within the terms of its mandate upon which the parties decide. In this lies the obligation to ensure that the parties are able to predict the outcome and regulations of their dispute and thus give full effect to the party autonomy. Even so, during the conduct of the proceedings, the arbitrators might be faced with rules invoked by states, concerning the protection of interests which the states find more important than the protection of the party autonomy. Subsequently, they might inflict limitations to the party autonomy.

To what extent are those rules respected by arbitrators?

As discussed in the introductory part, the arbitration is dependent upon states recognizing their awards. If the arbitrator continuously overlooked such mandatory laws, the states would supposedly be reluctant to recognize the awards, and consequently, the arbitration as a forum would suffer.⁸ Another consequence of disregarding mandatory rules is that an award might be annulled at the place of the seat of the arbitration. This leads to the arbitrator being faced with two primary concerns when conducting the proceedings. On one hand he must respect the will of the parties and on the other he must consider the fate of his award as to avoid an annulment or a refusal of enforcement.⁹

⁸ Chukwumerije(1994), *Choice of Law in International Commercial Arbitration*, p. 183

⁹ Lazareff(1996), *Mandatory Extraterritorial Application of National Rules*, p. 553

This dualism, to which there are several approaches and theories, will be the main frame when answering the first question raised in this thesis.

2.2 Definition of Overriding Mandatory Rules

2.2.1 Mandatory Rules

A definition of concerned rules is set forth by article 9 of the Rome I Regulation through which the wording in article 3 of the Rome Convention is clarified.¹⁰ The regulation provides for the definition of “overriding mandatory rules” and states;

“Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation”¹¹

Even if the Rome I Regulation only applies to the member states of the European Union, the definition is still useful as means of interpreting the word “overriding”.¹²

Accordingly, a mandatory rule is the label of those laws from which the parties cannot derogate and that the legislator might be required to apply irrespective of the governing law of the contract. They represent the fundamental policy of a state in the sense that they cannot compete with other foreign laws or the will of the parties.¹³ In order to ensure their application, the mandatory rules are given their overriding character.

¹⁰ Rome I Regulation (1980) The Rome Convention (1980) Article 3, paragraph 3

¹¹ Article 9, paragraph 1 of the Rome I Regulation (2008)

¹² Article 1(e) of the Rome I Regulation(2008) continues the delimitations set forth in article 1, paragraph 2(d) of the Rome Convention(1980)

¹³ Chukwumerije(1994), *Choice of Law in International Commercial Arbitration*, p.180

Two classic areas subject to an increasing protection through overriding mandatory rules are the consumer protection and the protection of employees, both of which are given excessive weight in separate articles of the Rome Convention. Similar provisions are now set forth in the Rome 1 Regulation, which has been reformulated, but yet still provides the same protection. If the requirements set forth in the regulation are met, an express choice of law by the parties shall not result in the deprivation of the protection afforded the consumer or the employee by such mandatory rules as would have been prevailing in the absence of a choice by the parties.¹⁴

As an example, the protection of the consumer is provided for in section 3 of The Consumer Sales Act of Sweden which states; “*Terms of contract which in comparison with the provisions of this Act are to the detriment of the buyer are null and void in claims against the buyer, unless the Act specifies otherwise.*”¹⁵ A consumer contract consisting of terms not conforming to the Swedish mandatory rules, would thus not, in accordance with the Rome 1 Regulation, be accepted in Sweden.

Besides these two classic areas which have been considered too important to be subject to a more general contemplation within the EU, it is not possible to determine exactly which rules will be characterized as overriding. The applicability of mandatory rules will have to be determined on the basis of “the function of the rules and the balance of the involved interests” together with the legal system to which the rule belongs.¹⁶ An evaluation of said conditions might result in a mandatory rule being considered applicable to the substance and thus overriding in the sense that it will limit the will of the parties.

Several mandatory rules provided for by the Norwegian legislation would have to be subject to such evaluation. As Norway is not a part of the EU, its mandatory rules will thus

¹⁴ The Rome 1 Regulation (2008), article 6, paragraph 2 and article 8, paragraph 1. Both articles are meant as exceptions of article 3 on the freedom of choice. This is expressly mentioned in both.

¹⁵ Konsumentköplagen (SFS 1990:932), September 6th 1990, section 3, paragraph 1

¹⁶ Cordero Moss(1999), *International Commercial Arbitration* , p. 105 and 325

not enjoy the protection provided for in the previous mentioned articles of the Rome I Regulation. Section 1-9 of the Employment Protection Act states that: Terms of contracts, which in comparison with the provisions in the Act, are to the detriment of the employee will be considered null and void.¹⁷ In an international context these rules might not be considered directly applicable.¹⁸

2.2.2 Public Policy

Public policy or *ordre public* are, in a way, closely connected to the concept of mandatory rules and consist of many of the same aspects. “*Mandatory rules would include those aspects of public policy and rules of national law that are couched in an imperative manner.*”¹⁹ While mandatory rules embody the vital socio-economic policies on a regulated basis, public policy protects the basic moral, economic and social principles of a particular society not already regulated by provisions of law. Areas of *ordre public* where there seem to be a general consensus as to the content are among others; corruption, smuggling and violations of embargo.²⁰

Due to the close connection between mandatory rules and public policy arbitrators and authors might treat them as they were the same. It is important to maintain that though they might represent many of the same values within a state, the public policy of a state is ranged as giving a direct ground for refusal of an award not conforming to it.²¹ Should the terms of a contract conflict with a mandatory rule, setting aside those terms would, in relation to the above discussed, require the mandatory rule being qualified as overriding.

¹⁷ Arbejdsmiljøloven, 17th of June 2005 no. 62 § 1-9

¹⁸ My translation

¹⁹ Chuckwumerije(1994), *Choice of Law in International Commercial Arbitration*, p 180-181

²⁰ Cordero Moss(1999), *International Commercial Arbitration*, p. 130

²¹ See for example: Article 34, paragraph 2(b)(ii) of the UNCITRAL Model Law (1985)

With regards to the overlapping between the mandatory rules of law and the rules of public policy it should be mentioned that while both Nygh and Chukwemerije seem, at least to some extent, to have accepted this analogy; Moss, on the other hand, is of the opinion that this should be avoided.²²

In all events, whether the rule is that of an overriding mandatory one, or characterized as public policy, arbitrators will consider its applicability under the circumstances of the party autonomy, its connection to the dispute and with due regard to the outcome of their award. This will be discussed in the following.²³

2.3 Applicable Mandatory Rules in Connection to the Seat of the Arbitration

2.3.1 The Lex Fori

Every judge of a national system will have his own lex fori. This means that he will have to respect certain mandatory rules of his own country, through which his powers has been conferred, irrespective of the contract being regulated by another law. As defined in art. 9.1 of the Rome I Regulation, such rules will be those safeguarding the public interests of a state.²⁴ As long as the requirements are met, application of the mandatory rules of the lex fori will not lead to any concerns for the judge.

As an example, section 5 of the Norwegian Act relating to the Law Applicable to Insurance Agreements clearly states that Norwegian mandatory rules shall always be considered overriding, notwithstanding the chosen law of the agreement.²⁵

²² Nygh *Choice of Forum and Law in International Commercial Arbitration*(1997), p. 26, Chukwumerije *Choice of Law in International Commercial Arbitration*(1994), p. 183 and Cordero Moss *International Commercial Arbitration*(1999), p. 329

²³ Despite the disagreements, the content of awards dealing with such issues indicates an overlapping between the two. This author recognises the differences, but has chosen to use the same analogue in this thesis.

²⁴ See point 2.2.1

²⁵ Forsikringslovvalgsloven 27th of November 1992 no. 111 § 5, my translation

From an arbitrator's point of view, the situation is far more complicated. He is not connected to any country in particular and thus neither a *lex fori*.²⁶ Even if the parties have made a choice on the place of the arbitration this may not always be due to the legislation connected to the country, but rather because of its geographical location or neutrality.²⁷

As an example, the Stockholm Chamber of Commerce has been chosen to resolve several disputes between the United States and the Russian Federation due to Sweden being considered politically neutral.

Another view in regards to the application of the *lex fori* is expressed by the judge in the U.S Supreme Court regarding the arbitrability in a dispute between Mitsubishi Motors Corp and Soler Chrysler-Plymouth Inc.²⁸ Soler, a corporation under US antitrust law had submitted the case to the US courts and claimed the dispute non arbitrable due to the fundamental character of the antitrust law of the US. The governing law chosen by the parties was Swiss Law. The judge began by stating:

“There is no reason to assume at the outset of the dispute that international arbitration will not provide an adequate mechanism. To be sure, the international arbitral tribunal owes no prior allegiance to the legal norms of particular states; hence, it has no direct obligation to vindicate their statutory dictates.”²⁹

²⁶ See for example: Cordero Moss *International Commercial Arbitration*(1999), p 327, Lazareff *Mandatory Extraterritorial Application of National Law Rules*(1996), p. 551 and Chukwumerije *Choice of Law in International Commercial Arbitration*(1994), p. 182

²⁷ Cordero Moss, *op.cit*, p. 328

²⁸ U.S 614 (1985), p 473 and Nygh, *Choice of Forum and Law in International Commercial Arbitration*(1997), p.25

²⁹ U.S 614 (1985), p 473

The statement indicates that there should be a clear distance between the obligations of a national court and an arbitral tribunal which, as will be discussed below, reflects a point of view that still has its supporters today.³⁰

From the above argued it might seem like the arbitrators are free to ignore the mandatory rules of the seat of the arbitration. However, having regard to the dualism mentioned in the general part, this may not always be so. As pointed out by Cordero Moss, the category of mandatory rules is not clearly defined which in turn may result in an overlap with the category of public policy.³¹ Arbitrators being faced with a rule which they consider to be a rule of the public policy may be more respectful towards the application of such, due to their obligations to ensure that the award will be binding upon the parties.

According to article 34, paragraph 2(b) (ii) in the UNCITRAL Model Law, an award may be set aside by the national court of the seat if the court finds that: “*the award is in conflict with the public policy of this state*”.³² Consequently, the application of mandatory rules of the seat of the arbitration will depend on “the degree of control the courts of that place can exercise over the arbitration, e.g. by preventing the arbitration from taking place or setting aside the award(...)”³³ In a direct connection to this art V, paragraph 1(e) of the New York Convention holds that recognition and enforcement of an award may be refused; e.g. if the award: “*(...)has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.*”³⁴ The application will thus also depend on the courts, in which the award could conceivably be sought, taking notice of the setting aside of the award by the courts of the seat.³⁵

³⁰ See point. 2.3.2

³¹ Cordero Moss, *International Commercial Arbitration*(1999), p. 329

³² UNCITRAL Model Law on International Commercial Arbitration (1985)

³³ Nygh, *Choice of Forum and Law in International Commercial Arbitration*(1997), p.26

³⁴ UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958)

³⁵ Nygh, *op.cit*, p.26

The latter signifies that arbitrators, having regard to the outcome of their awards, should consider the application of rules deriving from the public policy of the seat. Although this might seem reasonable, the theory presented below will indicate the contrary.

2.3.2 The Delocalisation Theory

The main feature of the delocalisation theory is to “detach an international commercial arbitration from control by the law of the place in which it is held.”³⁶

This theory was originally presented in relation to the application of procedural rules from the seat of the arbitration. The supporters of the theory emphasizes that due to the party autonomy, according to which the parties are free to choose the procedural rules of the arbitration, effect shall not be given to the procedural rules of the seat of the arbitration.³⁷

With regards to the application of mandatory rules of the *lex fori*, the supporters of the delocalisation theory will be equally reluctant to apply such rules on the arguments that they are not chosen by the parties and consequently neither foreseeable, which in turn would lead to a limitation of the party autonomy. Mandatory rules of the seat will only be applied to the extent they reflect “fundamental principles generally accepted on an international level.”³⁸ Hence, the above argued on the outcome of the award will not be subject to the same considerations by arbitrators supporting the delocalisation theory. Subsequently, they will focus on minimizing the restriction on the party autonomy, and if so, strictly on areas which the parties could have foreseen.

The further content of the delocalisation theory will be discussed in relation to the application of other mandatory rules in below.³⁹

³⁶ Redfern and Hunter *Law and Practice of International Commercial Arbitration*(2004), p. 104

³⁷ Redfern and Hunter *op.cit*, p. 104

³⁸ Cordero Moss, *International Commercial Arbitration*(1999), p. 329

³⁹ See point 2.4.2 and 2.5.2

2.4 Application of Mandatory Rules Deriving from the Governing Law of the Contract

2.4.1 The Lex Contractus⁴⁰

Mandatory rules could also derive from the law governing the contract. When the parties have made a choice on substantive law, the question is whether the arbitrators may apply the mandatory rules deriving from that particular choice. In relation to the latter, another question arises. Due to the principle on party autonomy, are the parties free to exclude the application of such mandatory rules in their agreement?

An argument towards the application of mandatory rules deriving from the *lex contractus* is that such rules would be consistent with the will of the parties. Having chosen a set of rules to govern the substance of the dispute, one might assume that the parties are familiar with its content, and thus its mandatory provisions. Consequently, the dualism mentioned in the general part, whereas an arbitrator will have to consider the faith of his award versus the will of the parties, will probably not be of any concern in this context.

An ICC Award rendered in 1990 is by several authors recognised as an answer to the question on applicable mandatory rules of the *lex contractus*.⁴¹

The tribunal exerted its obligation to apply Spanish *ordre public* due to the governing law being Spanish. The decree was evaluated as being a part of the public policy of Spain on the basis that it protected public interests. The side letter giving prevail to the French agreement was deemed invalid because it was considered as giving effect to a version which would violate the Spanish *ordre public*.⁴²

⁴⁰ Authors have used different terms of describing the law governing the contract (see e.g. Cordero Moss, p. 330), but for the sake of good order, *lex contractus* will be used here.

⁴¹ See Lazareff *Mandatory Extraterritorial Application of National Law Rules*(1996), p. 551-552 and Chukwumerije *Choice of Law in International Commercial Arbitration*(1994), p. 184, whom refers to the award in footnote 28.

⁴² ICC Award in case no 6142 of 1990, referred to by *ibid*. The dispute regarded a production licence, a technical assistance agreement and a trademark licence entered into between a French company as the

From a theoretical point of view, one might still argue that the parties freedom in choosing the governing law should extend to a freedom of excluding the mandatory rules of said law.⁴³ With reference to Chukwumerije whom affirms that; “the parties will prevail so far as it is consistent with relevant public policy”⁴⁴, and the above implied, it appears that party autonomy is subject to some limitations imposed by the public policy of a state. Accordingly, it might appear that arbitrators are not obliged to respect the derogation made by the parties under the considerations of party autonomy.

In practice; a Norwegian party enters into a distribution contract with a Indian party for the distribution of cars, and the parties have agreed on Norwegian law as the applicable law. In the agreement there is a clause excluding article 10 of the Norwegian Act on Competition.⁴⁵ As a consequence of the above argued the arbitrators may refuse to recognise this clause and legitimately apply the Norwegian mandatory competition rules.

The application of mandatory rules deriving from the *lex contractus* will follow from an express choice made by the parties. A logical consequence might be that such approach will find its support among the arbitrators giving prevail to the delocalisation theory.

licensor and two Spanish companies. The parties had chosen Spanish law as the governing law and the tribunal was seated in Paris. The agreement had been signed in two versions, a French one which contained of an early termination clause and a Spanish one which did not have this appendix clause. A side letter gave prevail to the French version in case of a collision between the two agreements, but only the Spanish letter had been submitted for approval by the Spanish Ministry of Industry. A Spanish decree, intended to prevent Spanish licensees being limited in their use of the licensed technology, rendered any such non registered transactions invalid.

⁴³ Chukwumerije, *Choice of Law in International Commercial Arbitration*(1994), p 184

⁴⁴ I.c.

⁴⁵ Konkurranseloven 5.mars 2004 no. 12, § 10

2.5 Applicable Mandatory Rules Foreign to the Contract or the Seat of the Arbitration

When a mandatory rule is not deriving from the *lex contractus* or the *lex fori*, it means that it is the rule of a third country which has some other connection to the dispute. The application of said rules has been subject to discussions among arbitrators and authors, and the practice is not uniform.⁴⁶ While the application of third laws in national courts are decided by the applicable private international rules of that particular state, arbitrators will have to decide on the applicability by other means. In fact, the disparities seem to lie in whether such mandatory rules are applicable at all. And if they are, under what circumstances?

In its essentials, the application of mandatory rules of a third state rests on the argument of the public policy.⁴⁷ From a logical point of view, the arbitrator having his main responsibility towards the parties should not have to be concerned about the public policy of third states to the same extent as a national judge. However, in reality, such concerns are becoming more and more acute due to the increasing matters falling under arbitration. Cases which traditionally would be subject to court proceedings in terms of their public law character, such as competition and environmental issues, are now entrusted to arbitration.⁴⁸ Consequently, arbitrators are faced with mandatory rules protecting vital interests of a state which might inflict considerations as to their applicability.

The newly implemented Rome I Regulation contains a provision in article 9.3 which regulates the application of foreign mandatory rules.⁴⁹ According to the regulation; “*Effect may be given to the overriding mandatory provisions of the law of the country where the*

⁴⁶ See for example; Cordero Moss *International Commercial Arbitration*(1999), p. 389, Chukwumerije *Choice of Law in International Commercial Arbitration*(1994), p. 180 and Lazareff *Mandatory Extraterritorial Application of National Law Rules*(1996), p. 552

⁴⁷ Nygh, *Choice of Forum and Law in International Commercial Arbitration*(1997), p.26

⁴⁸ Lazareff, *op.cit*, p. 552

⁴⁹ Rome I Regulation, June 2008. In force from December 2009.

*obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful.”*⁵⁰

Some support is also found in article 19 of the Swiss Private International Law Statute.⁵¹

The Code provides for the application of a mandatory provision of a third law provided the circumstances of the case are “*closely connected with that law.*”

In addition to ensuring that his award is not set aside, the arbitrator will have to “take into consideration the mandatory rules of the country or countries where enforcement of his award could conceivably be sought.”⁵² Article 36 letter b(ii) of the UNCITRAL Model Law explicitly provides for a refusal of the award if the court finds that recognition would be; “(...) *contrary to the public policy of this State.*”⁵³ A similar provision is set forth in article V(2)(b) of the New York Convention which provides for the refusal of an award by the competent courts of the state in which the recognition is sought, if those courts find that “*The recognition or enforcement of the award would be contrary to the public policy of that country.*”⁵⁴

In a decision rendered by the U.S Supreme Court regarding the arbitrability in a dispute between Mitsubishi Motors Corp and Soler Chrysler-Plymouth Inc., the question of applicability on third laws is raised by the judge.⁵⁵ As he allowed the dispute to be solved through arbitration despite the public law issues raised in the case, he stated:

⁵⁰ Art. 9.3 will replace the former art. 7.1 of the Rome Convention which provided for the application of the law of a third country with which the situation had a “close connection”.

⁵¹ Switzerland’s Federal Code on Private International Law of 1987. Article 19 states:

“If pursuant to Swiss Legal concepts, the legitimate and manifest preponderant interests of a party so require, a mandatory provision of a law other than that designated by this Code may be taken into account if the circumstances of the case are closely connected with that law.”

⁵² Lazareff, *Mandatory Extraterritorial Application of National Law Rules*(1996), p. 553

⁵³ UNCITRAL Model Law in International Commercial Arbitration (1985)

⁵⁴ UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958)

⁵⁵ U.S 614 (1985), p 473. See point 2.3.1 for the issues raised in the case

*“(...)the national courts of the United States will have the opportunity at the award-enforcement stage to ensure that the legitimate interest in the enforcement of the antitrust laws has been addressed. The Convention (The New York Convention) reserves to each signatory country the right to refuse enforcement of an award where the “recognition or enforcement of the award would be contrary to the public policy of that country.” Article V (2)(b)”*⁵⁶

Although it might seem clear that an arbitrator would be eager to avoid such refusal, the following discussions will show that there are disagreements with regards to the approach of these rules and whether they should be applied at all. Despite several attempts and efforts made by leading international organizations, the problems are not solved.⁵⁷ In order to get a clear picture on the problems raised in connection to this subject, a few theories, in which some explanations are sought, will be examined in the further. Additionally, the different approaches chosen by the arbitrators when met with this challenge will be discussed.

2.5.1 The Distinction between the System of Common Law and Civil Law

One theory, presented by Chukwumerije, draws a line to the distinction between civil and common law systems in proceedings before regular courts.⁵⁸ The main distinction between the two systems is their approach towards written rules. While the common law system seems to rely mostly on previous court decisions and usages, the civil law system, on the other hand, is more diligent in the use of preparatory works and written rules.

Chukwumerije holds that when it comes to arbitral practice, the arbitrators follow the same distinction between civil and common systems of law.⁵⁹ According to the common law

⁵⁶ U.S 614 (1985), p 473

⁵⁷ Lazareff, *Mandatory Extraterritorial Application of National Law Rules*(1996), p. 552

⁵⁸ Chukwumerije, *Choice of Law in International Commercial Arbitration*(1994) p. 185-187

⁵⁹ Ibid, p. 186

system, arbitrators are considered responsible for implementing the will of the parties and thus not invoke the public policy of states outside the *lex contractus*.⁶⁰

As cited by Chukwumerije, editors stating the law of England note that:

“Where a [mandatory law] is neither legislation of the forum nor of the applicable law, it has no application in England”⁶¹

In the United States, also a country of the common system, the attitude is still restrictive, but yet a little more liberal. The American Restatement of Conflict of Laws contains an acceptance of application of foreign rules “which has a materially greater interest than the chosen State in the determination of the particular issue”.⁶²

The argument for their reluctance is mainly based on the respect for the will of the parties. The party autonomy should prevail in so far as the parties may easily foresee which rules would govern their transactions and not cause any uncertainty.⁶³

On the contrary, the civil law system, are more favourable towards the application of foreign mandatory rules. This might derive from the civil law system overall being more respectful towards written laws and rules as stated in the foregoing.

The above mentioned article 19 of the Swiss Federal Statute on Private International Law is the best example on their attitude.

Although they are of different opinions, there seem to be a consensus to the fact that the law of the place of performance to some extent should be respected. While the civil law system will more easily adapt to this theory, the common law system, on the other hand,

⁶⁰ Chukwumerije, *Choice of Law in International Commercial Arbitration*(1994), p. 186

⁶¹ Ibid, p. 185

⁶² Ibid, p. 185 also see case in footnote 57.

⁶³ Ibid, p. 185-186

will justify the application by assuming that the parties intended to include the rule to begin with.⁶⁴

Chukwumerije is of the impression that the hostile view gives too much weight to the will of the parties and state that “the will of the parties is not sacrosanct; it may in appropriate cases give way to the legitimate concerns of those States whose interests are implicated by the dispute.”⁶⁵

As another argument he emphasizes that the application of mandatory rules is not necessarily contrary to respecting the will of the parties. Even if the parties have chosen a law to govern their dispute, this does not mean that they intended to excluded all mandatory rules outside the substantial law. As long as the parties have not expressly excluded the mandatory rules, their will should not be used as an excuse for ignoring the mandatory rules.⁶⁶

2.5.2 The Delocalisation Theory

In connection to the above presented on the distinction between the common law and the civil law system, it might be useful to analyse the approach taken by the supporters of the delocalisation theory.

This may best be described through the use in practice which for example is found in two awards rendered by the ICC.

In the first case the claimant, a consultant from state Y, claimed the enforcement of an agency agreement according to which a state agency should have paid commission for the

⁶⁴ Chukwumerije, *Choice of Law in International Commercial Arbitration*(1994), p. 186

⁶⁵ Ibid, p. 187

⁶⁶ Ibid, p.187

sale of military products to state X.⁶⁷ The state agency Z argued that the agreement was void on the basis of violation of mandatory rules in the state of performance, state X. The law contained provisions prohibiting a foreign national to engage in commercial agencies on its territory. Swiss law was chosen to govern the dispute. The arbitral tribunal by a decision of the majority held that the mandatory rules of state X were not applicable to the dispute because the parties had submitted their agreement to another law.

*“In the Agreement the parties expressly chose Swiss law, thereby expressing that any laws of third States conflicting with this Agreement should not be taken into account by the Arbitral Tribunal.”*⁶⁸

Another case submitted to the ICC, regarded a dispute between an Italian manufacturer and a Belgian distributor.⁶⁹ The tribunal concluded that the parties had agreed on Italian law and therefore held that Belgian overriding mandatory rules, prohibiting such distribution contracts from being submitted to arbitration, could not be applicable. The tribunal underlined that international arbitration is not a part of any national system and that national policies will not be given effect, unless deriving from the law chosen by the parties.

The content of the delocalisation theory is also presented by Lazareff, in what he calls the “Strict and Sole Application of the Lex Contractus.”⁷⁰ By this approach the arbitrator will act strictly at the service of the parties, but, however, with considerations to the

⁶⁷ ICC award in case no 7047 of 1994, *Yearbook XXI* (1996) p. 79-98, referred to by Cordero Moss, *International Commercial Arbitration* (1999) p. 342

⁶⁸ ICC award in case no 7047 of 1994, *op.cit*, p 79-98, referred to by Cordero Moss *op.cit*, p.342

⁶⁹ ICC award in case no 6379 of 1990, *The ICC International Court of Arbitration Bulletin* (1996) p. 83-86 and referred to by Cordero Moss, *op.cit*, p. 344

⁷⁰ Lazareff, *Mandatory Extraterritorial Application of National Law Rules*(1996), p. 554

international public policy.⁷¹ If the arbitrator takes on this approach, he will find the international public policy to be sufficient in ensuring the correctness of his award.

But, as Lazareff further affirms, there will always be overriding mandatory rules, “which do not violate international public policy and that an arbitrator cannot ignore in order to have his award enforced in a particular state concerned.”⁷²

This is also supported by Moss, whom indicates that the supporters of the delocalisation theory has taken on a cautious approach towards applying the mandatory rules through which the award will be recognised, in both the state of the seat of the arbitration and the state where the award might conceivably be sought.⁷³

Arbitrators that do not support the delocalisation theory will also have these considerations in mind when rendering an award, but thus not with the same reluctance towards the application. The different approaches will be discussed in the following.

2.5.3 The Functional Approach

2.5.3.1 The General View

This view is mainly referred to by Moss, but also confirmed through an article written by Lazareff on the subject.⁷⁴

What is implied by Moss in the context of the functional approach is that once a rule is characterized as overriding and has a sufficient connection with the matter in dispute, that

⁷¹ For the content of International Public Policy, see point 2.6

⁷² Lazareff, *Mandatory Extraterritorial Application of National Law Rules*(1996), p. 554-555

⁷³ Cordero Moss, *International Commercial Arbitration*(1999), p 352

⁷⁴ Cordero Moss, *op.cit*, p. 337-338 and Lazareff, *op.cit*, p. 555

rule should prevail over the chosen governing law.⁷⁵ This is in a way similar to what Lazareff presents as the approach where the arbitrator acts as he was a judge.⁷⁶ In national courts the judges are, in the same way as arbitrators, obligated to respect the law chosen by the parties, but as seen from point 2.5, the view towards accepting the application of third laws is increasing. The provisions set forth in the Rome Convention and the Swiss Private International Law Act both codifies this.⁷⁷

On the other hand, however, it should be mentioned that article 22 of the Rome Convention allowed the parties to derogate in their national legislation from the rules set forth in article 7(1).⁷⁸ This possibility was used by several contracting states, among them The United Kingdom and Germany, under the argument that such application would bring uncertainty upon the parties and that the application of third rules to a sufficient extent was covered by the provisions on force majeure and illegality.⁷⁹ Through article 9.3 of the Rome I Regulation, the uncertainty in the wording of article 7(1) is clarified which probably will lead to a different approach towards applying foreign rules. As a start, the United Kingdom has acknowledged this provision.

Norway has made use of a similar reservation in the above mentioned Norwegian Act relating to the Law Applicable to Insurance Agreements.⁸⁰ The law is based on an EU-directive which provides for the application of third laws and by means of avoiding uncertainties; Norway rejected the incorporation of rules allowing such application. Instead

⁷⁵ Cordero Moss, *International Commercial Arbitration*(1999), p 338

⁷⁶ Lazareff, *Mandatory Extraterritorial Application of National Law Rules*(1996), p 555

⁷⁷ The Rome Convention (1980), article 5, 6 and 7 and The Switzerland Federal Code on Private International Law of 1987, Article 19

⁷⁸ Article 22(1) of the Rome Convention (1980) states: “Any Contracting State may, at the time of signature, ratification, acceptance or approval, reserve the right not to apply: (a) the provisions of Article 7(1)”

⁷⁹ Cordero Moss, *op.cit.*, p. 118. See point 2.4.4

⁸⁰ Forsikringslovvalgsloven 27th of November 1992 no. 111

Norway chose to only incorporate the rule allowing the court to apply mandatory rules of the *lex fori*.⁸¹

2.5.3.2 Implementing the Approach to Arbitration

The question in the further is whether such approach might be implemented to arbitration. On one hand, the arbitrator would be sure of respecting the mandatory rules connected to the dispute, but on the other hand, a full application as such could be considered inadequate having regard to the party autonomy. In addition to imposing great limitations to the party autonomy, the evaluation pursuant to the application itself, might appear as unpredictable. As Lazareff points out; “(...) the approach has not engendered a very large consensus which probably explains why certain States have used the possibility given to them to make a reservation under (The Rome Convention) Art. 22”⁸²

In Switzerland however, even though not shared by all writers, legal authors have embraced article 19 of the Swiss Private Law, and holds that arbitrators having their seat in Switzerland should apply this rule.⁸³ Even though Moss finds this approach to be unpredictable and by arbitrators more affirmed in theory than in practice, some support are given to the foregoing when stating; “this category cannot be dismissed as a doctrinal construction with no effect in practice, because it is recognised and referred to in several key conventions and national legislation (...)”⁸⁴

⁸¹ See point. 2.3.2 and Cordero Moss, *International Commercial Arbitration*(1999), p 118

⁸² Lazareff, *Mandatory Extraterritorial Application of National Law Rules*(1996), p. 555

⁸³ Lazareff, *op.cit*, p. 555 and see footnote 41 for the content of article 19.

⁸⁴ Cordero Moss, *op.cit*(1999), p. 338

In an ICC award regarding a dispute in a technology licence agreement, the respondent invoked article 86 of the Rome Treaty.⁸⁵ Due to the governing law being Swiss, the arbitrators found that on the basis of its article 19, the competition rule of article 86 was to be applied.⁸⁶

2.5.4 Arbitrators Considering the Application under the Lex Contractus

By considering the terms of the contract (such as a force majeure or an illegality clause) in the light of the chosen governing law, foreign mandatory rules might be applied without having to make the considerations as discussed above, which requires the mandatory rule to be overriding and have a sufficient connection to the dispute.

This can be explained through an ICC award, governing the dispute between a Libyan Oil Company and an US Oil Company in which the governing law was Libyan.⁸⁷ The US implemented embargo legislation against Libya through which the US Company was denied a licence to export oil technology and prevented from flying their personnel to Libya. The US Company invoked the force majeure clause in the agreement. Considering the force majeure clause in which the Libyan law required the rendering of the performance to be impossible, the arbitrators held that the clause should be interpreted as absolute. The arbitrators then considered the force majeure clause in relation to the embargo legislation to conclude whether these mandatory rules made the performance impossible.⁸⁸

⁸⁵ Art. 86, first sentence of The Treaty of Rome(1957) states: “Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States.”

⁸⁶ ICC Award in case no 7673 of 1993, referred to by Cordero Moss *International Commercial Arbitration*(1999), p. 353

⁸⁷ ICC Award in case no 4462 of 1985, referred to by Cordero Moss, *op.cit*, p. 346-347

⁸⁸ ICC Award in case no 4462 of 1985, referred to by Cordero Moss, *op.cit*, p. 346-347

2.5.5 Arbitrators Considering the Enforceability of the Award

The advantages of the foregoing functional approach may still be taken into account without the arbitrator acting as a judge. By considering the foreign mandatory rules of the country where the enforcement could conceivably be sought, the arbitrator will ensure that the award is not rejected. This approach does not involve the evaluation as to whether a foreign rules is connected to the matter in dispute, it is “*simply based on practical considerations.*”⁸⁹

However, these practical considerations might impose practical problems. In order to invoke the correct rules, the arbitrators are dependent on knowing in which country the enforcement could be sought. This involves considerations as to whom might be the winner and in relation to that, where the loser might have assets which amounts to the compensation granted in the award. Especially in the more complicated cases, such overview might be difficult to obtain. In the smaller cases, on the other hand, enforcement is often sought in the place of the performance of the contract or in the parties respective countries which in turn would make the application easier.⁹⁰

This approach is adopted by the arbitrators of an ICC tribunal in a dispute between a French company and a Spanish company regarding a licence agreement.⁹¹ The governing law was French. In connection to the governing law, the tribunal considered whether the chosen law had any rules that would appear to contradict with the *ordre public* of Spain which in turn would prevent the award from being enforced in that country.⁹²

In relation to the foregoing, it should be mentioned that article 26 of the ICC rules provides;

⁸⁹ Cordero Moss, *International Commercial Arbitration*(1999), p. 354

⁹⁰ Cordero Moss, *op.cit*, p. 355

⁹¹ ICC Case no 3281 of 1981, *Clunet*, 1982 p. 990-993,991 and Cordero Moss, *op.cit*, p. 356

⁹² ICC Case no 3281 of 1981, *Clunet*, 1982 p. 990-993,991 and Cordero Moss, *op.cit*, p. 356

*“In all matters not expressly provided for in these rules, the Court of Arbitration and the arbitrator shall act in the spirit of these rules and shall make every effort to make sure that the award is enforceable at law.”*⁹³

In addition to the difficulties finding the assumable country of enforcement, another disadvantage connected to this approach might be the lack of neutrality with the arbitration process. In fear of their award not being enforced, the national rules of one of the parties might be given too much weight and thus resulting in an unequal treatment of the other party to the dispute. Subsequently, this might lead to the expansion of national legislation.

2.6 Transnational Public Policy

2.6.1 General View

The above discussed has focused on the limitations placed on the substantial governing law by the overriding mandatory rules and public policy of national legal systems. In the same way as the national public policy represent the moral and ethics of a state, there exists a transnational public policy providing an equal protection for the international business community. While national public policy represents the narrow national interests, *“transnational public policy represents the fundamental values, the basic ethical standards, and the enduring moral consensus of the international community”*⁹⁴ The principle on transnational public policy is widely acknowledged and every experienced arbitrator would apply these when necessary.⁹⁵

As examples of the fundamental rights represented, racial, religious and sexual discrimination shall be rejected by the arbitrators. There is a certain logic to the

⁹³ ICC Arbitration Rules, 1975

⁹⁴ Chukwumerije, *Choice of Law in International Commercial Arbitration*(1994), p. 192

⁹⁵ See for example; Lazareff *Mandatory Application of Extraterritorial National Rules of Law*(1996), p. 555, Chukwumerije *op.cit*, p. 192

responsibility of the arbitrators. As “guardians of the international commercial order”⁹⁶, they act as referees on the commercial arena and are thus responsible for the fair play and equality between the parties.

2.6.2 Effects on the Application of Mandatory Rules

Due to their position in the international commercial business, the principles are superior to the national mandatory rules. This means that even rules that forms part of the *lex contractus* would have to be set aside in the event they violate the transnational public policy. In terms of the evaluation, arbitrators will have to consider the concrete case with which they are faced, and subsequently determine whether the application of a mandatory rule would result in a violation of the transnational public policy. Pursuant to the uncertainty surrounding the application of foreign rules a remark should be made. In the event that the foreign mandatory rules reflect those of the international public policy, they could be applied by the arbitrator.⁹⁷ This is, as expressed by Lazareff, due to the rules “*being equivalent to the direct transportation by the arbitrator of an internationally recognized general principle of commercial law.*”⁹⁸

⁹⁶ Chukwumerije, *Choice of Law in International Commercial Arbitration*(1994), p. 192

⁹⁷ Lazareff, *Mandatory Extraterritorial Application of National Law Rules* p. 556

⁹⁸ Lazareff, *op.cit*, p. 556

PART II

3 Introduction to the Different Approaches Chosen by Arbitrators in Determining the Applicable Law

3.1 General

Under the party autonomy the parties are given an excessive right to choose the *lex contractus* and subsequently the law to govern an eventual dispute between them. In accordance with modern national and international laws, the parties may as well choose to have their dispute solved by general rules of law, or in accordance with what the arbitrators considers being fair and just.⁹⁹ Either way, arbitrators are obliged to apply the law expressly chosen by the parties. This may be a indication of the party autonomy being a conflict rule in itself.

As most contracts do contain a choice-of-law clause in which the law to govern the merits of the dispute is stipulated, the opposite is rarely a problem. Nevertheless, it does happen that contracts are settled without a choice on governing law whether this originates from a failure or a breach in the negotiations. In the event a dispute is submitted to national courts, every judge will have his own set of private international conflict of law rules directing him on what should be applied as the appropriate substantive law. In terms of an absence of a choice in arbitration, the situation is more complicated. Consequently, being without a *lex fori*, the arbitrator will not have a set of prearranged rules to rely on. What approach will he then choose in order to determine the appropriate law? Contradictory to national court systems, there are very few constants in arbitration. Not only will the subject matter differ, but the nationalities, the place of performance, the procedure rules and the place of the seat

⁹⁹ See for example article 28, para 1 and 3 of the UNCITRAL Model Law (1985)

will all have to be considered in each particular case and will have its individual affect on the choice of governing law.¹⁰⁰

3.2 Considering the Terms of the Contract

Although the parties have failed to make a choice on governing law, there are situations where the dispute might be solved based on the terms of the contract.

As the contract represents the main feature of the party autonomy, this is a natural starting point. If the terms set forth in the contract are sufficient to resolve the dispute and do not violate the mandatory rules of the states involved, an application of substantive governing law is redundant.¹⁰¹ Consequently, the considerations discussed in the further will only be relevant in the events where the contract terms do not provide an adequate basis for a decision.

3.3 Tacit, Implied or a Negative Choice by the Parties

Even where the contract does not provide a sufficient basis, the solution might be sought by other means. Trough the contract or other documents submitted to the case, the arbitrators may interpret a tacit or implied choice of law by the parties. This is called the subjective approach and involves considerations pursuant to the hypothetical will of the parties.¹⁰²

The arbitrators will be faced with the task of evaluating all circumstances to the matter in connection to the contract, in order to determine whether it appear as sufficient to infer a tacit or implied choice.¹⁰³ Neither the choice of the seat of the arbitration, nor the choice on procedural rules is considered sufficient in determining such choice on governing law.¹⁰⁴

¹⁰⁰ D.M Lew, *Relevance of Conflict of Law Rules in the Practice of Arbitration*(1996), p. 447

¹⁰¹ Chukwumerije, *Choice of Law in International Commercial Arbitration*(1994), p. 125

¹⁰² Blessing, *Regulations in Arbitration Rules on Choice of Law*(1996), p.406

¹⁰³ Blessing, *op.cit*, p. 396

¹⁰⁴ I.c.

In regards to the absence of a choice by the parties, it is emphasized that the arbitrators should distinguish between the absence of a choice and a negative choice.¹⁰⁵ Where the absence of a choice might be an indication of a failure; a negative choice, on the other hand, might be an indication of an express choice by the parties. In failing to agree on the applicable law, the parties may, by means of directing the choice to the arbitrators, omit a governing law clause in their contract. Possible effects of a negative choice as such, will be analysed below.¹⁰⁶

3.4 The Delocalisation Theory

As discussed above, under section 2.3.2, the delocalisation theory provides for the separation between the conduct of the arbitration and the seat of the arbitration. While the theory has been met with scepticism on other areas, it enjoys a wider consensus with regards to the application of conflict rules.¹⁰⁷ It is acknowledged through several modern arbitration laws that application of private international law or conflict of law rules shall not be determined by the seat of the arbitration.¹⁰⁸ Moss; writing before the Norwegian Arbitration Act came into force, has briefly mentioned the legal doctrine, suggesting that the Act should consist of a rule providing for Norwegian conflict rules.¹⁰⁹ To this, she also affirmed that; “at the same time, however, it has been recognised that the general validity of this assumption is threatened by the delocalisation theory.”¹¹⁰ As opposed to the latter, and what appears to be the consensus, the Norwegian Arbitration Act consists of a rule

¹⁰⁵ Lalive, *The UNIDROIT Principles as Lex Contractus, With or Without an Explicit or Tacit Choice of Law: An Arbitrator's Perspective*, (2002)

¹⁰⁶ See discussions under point 4.3.1

¹⁰⁷ Cordero Moss, *International Commercial Arbitration* (1999), p. 247

¹⁰⁸ See for example, article 28, paragraph 2 of the UNCITRAL Model Law, section 46, paragraph 3 of the English Arbitration Act and article 17, paragraph 1 of the ICC Arbitration Rules.

¹⁰⁹ Cordero Moss, *op.cit*, p. 248-249

¹¹⁰ I.c.

stating that in the absence of a choice by the parties, the Norwegian conflict rules applies.¹¹¹

3.5 Application of the Choice of Law Rules of the Arbitral Seat

In spite of the foregoing, arbitration awards are found in which the application of conflict of law rules are based on the private international law of the seat.

One example is the Götaverken Case, rendered by the ICC which during the case was seated in France. Without taking into consideration the uncertainty surrounding the application of the conflict laws of the *lex fori*, the tribunal affirmed that; “The applicable law to the contracts is determined either by an international convention or by the conflict of law rules of France, as the country of the place of arbitration.”¹¹²

In the context of the delocalisation theory it is interesting to remark that this award was rendered in 1978 and might thus not be an indication of the trend today. The application of the conflict of law rules of the seat was consistent with an application of the whole system of private international law of that particular country. As further discussions will show, modern arbitration law provides for an application of a particular conflict rule, rather than a whole system.

However, this does not exclude the arbitrators from considering the rules of the *lex fori* relevant where the law of the seat has some other connecting factors to the dispute, which might be in cases where the contract is to be performed at the seat, or one of the parties

¹¹¹ Voldgiftsloven, 14th of May 2004 no. 25

¹¹² ICC Award in case no 2977 of 1978, referred to by Cordero Moss, *International Commercial Arbitration*(1999), p. 251

have their residence there.¹¹³ Awards are also found, in which arbitrators consider the rules of the seat to be applicable on the basis that the seat is expressly chosen by the parties.¹¹⁴

3.6 Choice of Conflict Rules that are Considered Applicable

In accordance with modern arbitration rules, arbitrators might take on the approach of applying the conflict of law rules they deem appropriate. As stated by the tribunal in an ICC Case: “A tribunal should, accordingly, no longer be expected to apply a conflict of law system (in its entirety, such as the one prevailing at the forum), but should be free to only determine the appropriate conflict rule (which is a notion significantly different from a “system”), and such rule can form part of any national or a-national rules of private international law”.¹¹⁵ This is often called the “voie indirecte”. As an example: Article 28, paragraph 2 of the Model Law provides for such application.¹¹⁶

3.6.1 Cumulative Application

When determining the applicable conflict rules, the arbitrators may come across situations where the private international laws of the states involved in the dispute, all point to the same substantive law. Under these circumstances, the arbitrators often choose to cumulate the laws, and thus avoid the considerations as to which conflict of law rule should be applied. As expressed by an arbitrator in an ICC Case, the arbitrator would have to show that there are similarities between the conflict rules of the different states involved in the

¹¹³ Chukwumerije, *Choice of Law in International Commercial Arbitration*(1994), p. 128

¹¹⁴ See for example case no. 80/1998 rendered in 2000 p. 50, where the tribunal concluded that the Swedish law could be ignored on the basis that the seat was not selected by the parties and ICC Case no 8672 in ICC International Court of Arbitration Bulletin Vol. 12 No. 1, 2001 where the tribunal made the same considerations.

¹¹⁵ ICC Case no 9117, ICC International Court of Arbitration Bulletin Vol. 10 No. 2, 1999

¹¹⁶ UNCITRAL Model Law, 1985

dispute, or that they lead to the same result.¹¹⁷ If such, “they have the power to apply these common conflict rules since they can be sure of satisfying the implicit or supposed intention of the parties from which they derive their power.”¹¹⁸

The positive effects from such cumulative approach might in certain events result in arbitrators making a somewhat superficial interpretation of the concerned rules. In order to find a solution through which all the concerned legislations are respected, rules that might not have the same content will be cumulated.¹¹⁹

This was the case in an ICC Award dealing with a dispute between an US and an Italian Company regarding an agreement for the right to manufacture and sell equipment based upon the Italian Company’s patent and proprietary technology.¹²⁰ According to the terms of reference the arbitrators were to decide on the substantial law, whereas the arbitrators compared the private international rules of Italy, the US and Switzerland (as the seat of the arbitration) in accordance with recent arbitration practice providing for such cumulative application. The tribunal found that they all indicated the substantive law with the closest connection. After having concluded that the Swiss law designated the law of the licensor (Italian company) to be applicable, whilst the two other designated the law of the licensee (the US Company) to be applicable, they added that the Swiss solution had been criticized and concluded that the US Law would be applied. Despite the interpretation leading to a contradictory result in terms of the Swiss Law, the tribunal argued; “considering all the circumstances of the facts, a solution which would apply American law and Massachusetts

¹¹⁷ ICC Award no 1176, referred to by Chukwumerije *Choice of Law in International Commercial Arbitration*(1994) p. 128

¹¹⁸ ICC Award no 1176, referred to by Chukwumerije *op.cit*, p. 128

¹¹⁹ Cordero Moss *International Commercial Arbitration*(1999) p. 256

¹²⁰ ICC Award no. 5314, ICC International Court of Arbitration Bulletin Vol. 4 No. 2

law, as the law governing this dispute, would certainly be admissible under Swiss Rules of Conflict.”¹²¹

3.6.2 Application of General Principles of Private International Law

Taking on this approach, an arbitrator will refer to a widely recognised international conflict of law rule, implemented in international conventions.¹²² The argument towards the application of general principles is the presumption that such rules are adopted by several national states and thus enjoy a wide recognition.¹²³ On the other hand, such application might be given effect, even though states connected to the dispute, have not adopted the particular rules.¹²⁴ It is generally recognised that a state is only bound by a convention to which it has committed itself through ratification. In the event that a state has not ratified a convention, and provisions deriving from said conventions are used in an arbitration to which that state has a close connection, the whole concept of ratification might be less significant.¹²⁵

Yet, arbitrators apply general principles on private international law as the applicable conflict of law rules.

This was done in a case before the ICC regarding a dispute between a Spanish tool manufacturer and a German agent.¹²⁶ The parties had failed to make a choice on governing law and the arbitrators found that due to the seat being chosen by the institution, the rules of the *lex fori* could not be applied. Being subject to the old rules of the ICC, the arbitrator had to decide on applicable conflict of law rules, under which he still enjoyed a large

¹²¹ ICC International Court of Arbitration Bulletin Vol. 4 No. 2, case no. 5314, also referred to by Cordero Moss *International Commercial Arbitration*(1999), p. 256

¹²² Cordero Moss, *op.cit.*, p. 257

¹²³ *I.c.*

¹²⁴ *I.c.*

¹²⁵ *I.c.*

¹²⁶ ICC Case no 8672, 1996, ICC International Court of Arbitration Bulletin Vol. 12 No. 1, 2001

freedom as to the choice itself. While considering the elements of the dispute in order to determine the applicable substantive law, the arbitrator concluded without any further reference to the evaluation, that the applicable conflicts of law rules were those of general principles of private international law.¹²⁷

3.7 Close Connection Test

In determining the law to be applied to the dispute, arbitrators may take on the approach of applying the rule which is considered to be most closely connected to the contract. By comparing the rules of private international law connected to the dispute in connection with the requirements set forth by concerned rules, the arbitrators may decide on the rule with the closest connection. This procedure is also often used as means of determining the appropriate conflict rule in terms of the approaches mentioned in the foregoing.¹²⁸ In all events this approach is pursuant to the application of a particular conflict rule, rather than the whole system of private international law in its entirety.¹²⁹

Article 4 of the Rome Convention expressly provides for this application in the absence of a choice by the parties.¹³⁰ The new Rome I Regulation has continued the general notions of the close connection test set forth in the convention, but provides for a more detailed regulation under particular contracts.¹³¹

3.8 A Direct Choice of Law

Article 17 of the ICC Rules states that in the absence of an agreement on the substantive law between the parties, “the Arbitral Tribunal shall apply the rules of law which it

¹²⁷ ICC Case no 8672, 1996, ICC International Court of Arbitration Bulletin Vol. 12 No. 1, 2001

¹²⁸ Cordero Moss, *International Commercial Arbitration*(1999), p. 259

¹²⁹ Blessing, *Regulations in Arbitration Rules on Choice of Law*(1996), p.412

¹³⁰ Article 4, paragraph 1 of the Rome Convention (1980)

¹³¹ The Rome I Regulation (2008). See article 4; paragraph 3 which according to its wording should be applied if paragraph 1(a)-(h) and paragraph 2 are not applicable.

determines to be appropriate.”¹³² The introduction to this approach was first presented by the French Civil Code of Procedure in 1980 and empowers the arbitrators an extensive freedom compared to the approaches examined above.¹³³ Under those terms, the direct application might be considered somewhat revolutionary. The direct approach, often called the “voie directe”¹³⁴ has also inspired the new rules of the SCC Rules of Arbitration which in its article 22, paragraph 1 expressly provides for the application of “*law or the rules of law which it considers to be most appropriate.*”¹³⁵

In applying the “voie directe”, arbitrators have commonly made use of general principles of law above the private international law. This will be discussed in detail in chapter 4.

3.8.1 Considerations under the “voie directe”

Being a relatively new approach, the direct application is seen as the new trend in arbitration. Yet, several arbitrators still prefer to make considerations which in some way correspond with the considerations under the application of conflict of law rules. In this context, the difference will lay in the arbitrators not being bound to apply a particular system of conflict of law rules, but rather apply those they deem fit without any further explanations.

In case no 9415 submitted to the ICC, the arbitrators whom were to decide a dispute between an Indian purchaser and a Turkish seller, made such considerations.¹³⁶ Having its seat in the Netherlands, the arbitrators looked to the conflict of law rules of the The Netherlands Arbitration Act, which provided for the direct choice of a substantive law

¹³² Art 17, second sentence, ICC Rules of Arbitration (1998)

¹³³ Art. 1496 of the *French Nouveau Code de Procédure Civile* 1980

¹³⁴ See for example: Blessing, *Regulations in Arbitration Rules on Choice of Law*(1996), p. 413 and Derains, *The Role of the UNIDROIT Principles in International Commercial Arbitration (1): A European Perspective*(2002)

¹³⁵ SCC Arbitration Rules, 1 January 2007

¹³⁶ ICC Case no 9415, ICC International Court of Arbitration Bulletin Vol. 13 No. 2, 2002

(Voie directe). In considering its content and its similarities with the French Code of Civil Procedures, the arbitrators affirm that: *“It is also drafted in view of the modern practice prevailing in international arbitration.”* But due to the parties submitting their arbitration to the ICC Institution, the rules of the latter had to be taken into consideration as well. This award is rendered in 1998, thus, before the new rules of the ICC came into force. Consequently, the old rules of the ICC, under which article 13(3) prevailed, were given effect. As the old ICC Rules provided for the choice of conflict rules that the arbitrators deemed appropriate, whilst the Netherlands Arbitration Act provided for a direct choice, the arbitrators had to consider the application of both. Notwithstanding the different approaches of the rules, the tribunal concludes that: *“(…)under the direct choice rule, arbitrators must still apply some conflict of law rule for determining the applicable substantive law. The only difference would seem to lie in the choice of the system of the conflict of laws rules. Under the indirect choice method, the arbitrators must expressly determine which system (national or international) they deem applicable. On the other hand, under the direct method, arbitrators may simply choose conflict rules they deem fit, without being bound by one particular system.”*¹³⁷ This leads to the tribunal applying the conflict of law rules of the Netherlands *“and the conflict of laws rules as generally applied by international arbitrators in similar cases.”*¹³⁸ The wording of article 13(3) was considered not to prevent such application.¹³⁹

In a second case considering the “voie directe”, the tribunal made the same considerations which in this case lead to the application of one particular set of conflict of law rules.¹⁴⁰ The case was submitted to the SCC and the tribunal were to decide a dispute between company Y and company V regarding a compliance of delivered equipment and an obligation to pay the rest of the purchase price. As the parties had failed to make a choice, the tribunal were to decide on the governing law. The tribunal starts by concluding that

¹³⁷ ICC Case no 9415, ICC International Court of Arbitration Bulletin Vol. 13 No. 2, 2002, point 66

¹³⁸ ICC Case no 9415, ICC International Court of Arbitration Bulletin Vol. 13 No. 2, 2002, point 68

¹³⁹ ICC Case no 9415, ICC International Court of Arbitration Bulletin Vol. 13 No. 2, 2002, point 68

¹⁴⁰ SCC Case no 10/2005, rendered in 2006.

both the application of international conventions, which they find to be applicable directly and the appropriate conflict of law rules, need to be considered. The arbitrators conclude that CISG¹⁴¹ is to be applied. In the event that CISG did not govern all the issues, the tribunal holds that national law would have to be applied to fill the gaps. This would have to be determined in accordance with article 22, paragraph 1 of the SCC Arbitration Rules. In connection to this, the tribunal states; “This is in line with the more recent developments in international arbitration (...).”¹⁴²

Yet, this is not in line with the view of the arbitrators whom further affirm; “However, in the opinion of the Tribunal, this issue cannot be solved without taking into consideration the existing conflict of law rules, as they constitute a relevant test of the appropriateness of the chosen substantive law.”¹⁴³

As the parties in this case had designated the forum of the tribunal, the arbitrators choose to apply Swedish conflict of law rules, which in turn led to the application of the Rome Convention. Subsequently, the close connection test in article 4, paragraph 5 of the Rome Convention was applied. This resulted in Austrian law as the governing law next to the CISG.

¹⁴¹ UN Convention On Contracts For The International Sale Of Goods (1980)

¹⁴² SCC Case no 10/2005, rendered in 2006, p. 252

¹⁴³ SCC Case no 10/2005, rendered in 2006, p. 252

4 The Scope of the Freedom in Applying the Substantive Governing Law

Most of the approaches examined in the previous chapter involves the application of conflict of law rules deriving from a private international law. Thus, one might say the conflict of law rules represents a part of the private international law system. However, in the past decades, the rules relating to arbitration have become more liberal.¹⁴⁴ According to the direct application, the arbitrators are allowed to apply the substantive law without going via the conflict of law rules. Under such circumstances, an arbitrator may abandon the private international law, and instead apply general principles of law. Before discussing the content and scope of application of these general principles, the extent of the arbitrators freedom will be examined. What are the consequences of the choice of law made by the arbitrator, and to what extent is his powers to apply a certain governing law decided by the rules through which he derives his powers?

4.1 The Arbitrators Freedom¹⁴⁵

4.1.1 Actual or Implied Freedom?

Several conventions and regulations contains of provisions empowering the arbitrator to determine the governing law in accordance with further requirements set forth in the provisions and through which the arbitrator's freedom is extensive. As inquired in the foregoing, the powers of an arbitrator are to a certain extent defined by the courts where the enforcement of the award could conceivably be sought. A ground for the refusal of an award would often be when the award is not conforming to the public policy of the enforcing state. However, "in this case it is not the choice of law as such that is at issue, but the solutions it provides with respect to the merits."¹⁴⁶ By examining the rules set forth in article V of the New York Convention on the grounds for refusal of an award, there is no

¹⁴⁴ See for example: Art. 1496 of the *French Nouveau Code de Procédure Civile* 1980

¹⁴⁵ Derains, *The Role of the UNIDROIT Principles in International Commercial Arbitration (1): A European Perspective*(2002) point 5

¹⁴⁶ Derains, *op.cit*

mention of the question of applicable substantive law.¹⁴⁷ This makes, as stated by Derains, the freedom of the arbitrator more often implied than not.¹⁴⁸ More however, compared to regular courts, the arbitrators still enjoys a large freedom. As early as 1957, Henri Batiffol expressed that; “an arbitrator is not bound to apply the rules of conflict of one country rather than another.”¹⁴⁹

4.1.2 Application of “Law” or “Rules of Law”

Evidently, an arbitrator’s freedom is limited through an express choice on governing law by the parties. If the *lex contractus* is established, the arbitrator will be obliged to decide the dispute in accordance with such choice. In the absence of a choice, the arbitrator will also be subject to limitations set forth by the laws from which his power derives. These could be deriving from a national law, an arbitration institution or other arbitration rules.¹⁵⁰ A significant difference in the content of these provisions is their reference to the application of “law” or “rules of law”. Several authors seem to have concluded that the word “law” is concurrent with national law, which means that an arbitrator faced with such rules would not be authorized to apply general rules of law.¹⁵¹ An indication of the different content of the wording is visible in the provisions set forth in article 28 of the UNCITRAL Model Law.¹⁵² Paragraph 1 clearly states that the tribunal shall decide the dispute in accordance with such “rules of law” as chosen by the parties.¹⁵³ Paragraph 2,

¹⁴⁷ Article V, paragraph 1 and 2 in the New York Convention (1958) refers to several grounds for refusal or non-recognition of awards.

¹⁴⁸ Derains, *The Role of the UNIDROIT Principles in International Commercial Arbitration (1): A European Perspective*(2002)

¹⁴⁹ Cited by Derains, *op.cit*, point 12

¹⁵⁰ Derains, *op.cit* point.9

¹⁵¹ See for example; Blessing, *Regulations in Arbitration Rules on Choice of Law*(1996), p. 430 and Cordero Moss, *International Commercial Arbitration*(1999), p. 265

¹⁵² UNCITRAL Model Law on International Commercial Arbitration (1985)

¹⁵³ Art. 28, paragraph 1, first sentence of the *op.cit* reads: “*The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute.*”

however, providing for the method to be applied if the parties have failed at such choice, states that the arbitrators shall apply the “law” determined by the conflict of law rules which it deems applicable.¹⁵⁴

The rules regulating arbitration are not unanimous. With regards to their wording, some rules appear to be more liberal than others.

The French New Code of Civil Procedure states in its article 1496, that the arbitrators shall decide the dispute in accordance with the “*rules of law*” chosen by the parties, and in the failure of such, “*according to those they deem appropriate.*”¹⁵⁵

Section 46 of the English Arbitration Act, on the other hand, provides for the application of “*the law determined by the conflict of laws rules which it considers applicable.*”¹⁵⁶

The parties’ freedom of choice in arbitration also extends to the choice on arbitration rules to govern the proceedings. As will follow, such choice may also have a significant impact on the arbitrators’ freedom of application.

If the parties have chosen to submit their arbitration to ICC, the arbitrators will enjoy a large freedom in applying the governing law in accordance with article 17, paragraph 1 which allows the arbitrator to apply the “rules of law” they deem appropriate.¹⁵⁷

On the contrary, should the parties decide on an ad hoc arbitration, using the UNCITRAL Arbitration Rules, article 33, paragraph 1, would limit the arbitrators to apply the “law” determined in accordance with said conflict of law rules.¹⁵⁸

¹⁵⁴ Art. 28, paragraph 2 of the *op.cit* states; “*Failing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of law rules which it considers applicable.*”

¹⁵⁵ Decree n°81-500 of 12 May 1981, Official Journal of 14 May 1981, The French Code of Civil Procedure

¹⁵⁶ 1996 English Arbitration Act, section 46(3).

¹⁵⁷ ICC Rules of Arbitration, 1998

¹⁵⁸ UNCITRAL Arbitration Rules, 1976

The result of the foregoing could be that an ICC Arbitration seated in London would be empowered to apply “rules of law” as the applicable law, whereas an arbitration conducted under the UNCITRAL Rules seated in Paris would be limited to apply “law” instead of “rules of law”.¹⁵⁹

4.2 General Principles of Law

The application of general principles of law indicates an abandonment from private international law in the sense that the tribunal does not apply conflict of law rules or any other rules deriving from a national system of law, but rather from general rules not part of a private international system of law, such as the Lex Mercatoria.¹⁶⁰ The *Lex Mercatoria* consists of rules and practices which have been developed within international business communities.¹⁶¹ As an example, The UNIDROIT Principles are considered a part of the lex mercatoria.¹⁶²¹⁶³ The aim of the principles is to establish a neutral set of rules to be used throughout the world.¹⁶⁴ By means of giving a more complete definition of the lex mercatoria, one might make use of a description set forth by the tribunal in a recent ICC Award.¹⁶⁵ On the further content of the Lex Mercatoria, the tribunal affirmed; “*that is the rules of law and usages of international trade which have been gradually elaborated by different sources such as the operators of international trade themselves, their associations, the decisions of international arbitral tribunals and some institutions like Unidroit and its recently published Principles of International Commercial Contracts.*”

¹⁵⁹ Derains, Yves *Role of the UNIDROIT Principles in International Commercial Arbitration (1): A European Perspective*(2002), point 9

¹⁶⁰ Nygh, *Choice of Forum and Law in International Commercial Arbitration*(1997), p.22

¹⁶¹ Redfern and Hunter *Law and Practice of International Commercial Arbitration*(2004), p. 127

¹⁶² Principles of International Commercial Contracts 1994 - UNIDROIT

¹⁶³ Redfern and Hunter, *op.cit*, p. 132

¹⁶⁴ Redfern and Hunter, *op.cit*, p. 132

¹⁶⁵ ICC Case no 9875, ICC International Court of Arbitration Bulletin Vol. 12 No. 2, 2001

Due to their increasing importance and discussions surrounding them in international arbitration, the UNIDROIT Principles will be given a more detailed examination.¹⁶⁶

4.3 Considerations under the Application of the UNIDROIT Principles¹⁶⁷

It is generally acknowledged that the principle of party autonomy provides the parties with an extensive freedom in choosing the law or rules of law to govern their contractual relationship. With regards to the UNIDROIT Principles, both arbitral practice and literature seem to have accepted them as a valid choice.¹⁶⁸ Issues that will be given considerations in the further are whether the scope of the arbitrator's freedom is as far reaching as the parties freedom pursuant to their application in the absence of a choice by the parties.

According to the preambles of the UNIDROIT Principles; "*They may be applied when the parties have not chosen any law to govern their contract.*"¹⁶⁹

In applying the UNIDROIT Principles to govern a dispute, considerations should be made as to whether the rules are subject to a decision "*ex aequo et bono*"¹⁷⁰ or whether they fall under the category of law.¹⁷¹ If the first was to prevail, an application of the principles would depend upon the parties entrusting the arbitrators with such powers. This is expressly stated in e.g.; Article 17.3 of the ICC Arbitration Rules.¹⁷² However, if the

¹⁶⁶ See for example D.M Lew and Lalive both on *The UNIDROIT Principles as Lex Contractus, With or Without an Explicit or Tacit Choice of Law: An Arbitrator's Perspective*(2002) and Cordero Moss *International Commercial Arbitration*(1999), p. 260-273

¹⁶⁷ Considerations in relation to the UNIDROIT Principles will be regarding other general principles as well

¹⁶⁸ Lalive, *op.cit*

¹⁶⁹ UNIDROIT Principles of International Commercial Contracts, Preambles, sentence 4.

¹⁷⁰ Meaning that the dispute is to be solved in accordance with the arbitrators equity and conscience

¹⁷¹ Cordero Moss, *op.cit*, p. 264

¹⁷² Article 17, paragraph 3 of the ICC Rules of Arbitration (1998) states: "*The arbitral Tribunal shall assume the powers of an amiable compositeur or decide ex aequo et bono only if the parties have agreed to give it such powers.*"

principles are characterized as rules of law, the arbitrators are empowered to apply them without any consent from the parties. As will be seen from the awards presented below, the latter seems to prevail. As a consequence of being characterized as a “rule of law”, it is important to emphasize that such principles may not be applied under the rules, which according to their wording are giving effect to the application of “law” only.¹⁷³ The rules constituting the possibility for a direct application of governing law on the other hand, expressly provides for the application of such “rules of law”. This is also a logical explanation as to why the UNIDROIT Principles are so often applied under the direct application approach as briefly mentioned above.

Another issue is whether a choice of the UNIDROIT Principles would inflict any obstacles upon the award at a later stage e.g. through a national court setting aside the award. In this aspect, with reference to article V of the New York Convention, the particular choice of law is not considered a ground for refusal of the award.¹⁷⁴ Accordingly, a question of the application should be answered affirmative.¹⁷⁵ However, arbitrators should still give careful attention to the importance of the private international law due to the equivalent connection between the contract and national legal systems. Irrespective of whether the arbitrator choose to apply general principles of law, he must still give due considerations to the possible impact or effect of mandatory rules or public policy of connected private international laws.¹⁷⁶

¹⁷³ See discussions in point 4.1.2

¹⁷⁴ See footnote 145 and further discussions under 4.1.1

¹⁷⁵ Lalive, *The UNIDROIT Principles as Lex Contractus, With or Without an Explicit or Tacit Choice of Law: An Arbitrator's Perspective*(2002)

¹⁷⁶ Lalive, *op.cit*

4.3.1 Application of the UNIDROIT Principles

Following the question of applicability of the UNIDROIT Principles in preference to the application of a private international conflict of law rule, the answer might be sought through arbitration awards.

In a case submitted to the ICC, the tribunal has clearly expressed its view on such application¹⁷⁷ The tribunal maintained that i) when there was no express choice on any national law, ii) the neutrality regarding the applicable law was a paramount concern and iii) the parties had submitted their dispute to international arbitration; *“it can only be concluded that no national law was judged adequate or adapted to govern such transactions without the risk of disturbing the balance of neutrality between the parties.”* As a consequence of the concluded, the tribunal affirms that: *“they only left room for the application of general legal rules and principles adequate enough to govern the Contracts but not originated in a specific municipal legal system.”*

In their reasoning, the tribunal also emphasizes an important interpretation of an express negative choice by the parties. *“Such “negative” choice by the parties commands as much respect as any express choice of law would have commanded, had the parties inserted choice of law stipulations in the Contracts; therefore, in order not to disrupt the parties’ common understanding in that regard, this Tribunal must refrain from the choice of any national law as proper law”* Hence, arbitrators being faced with a contractual dispute where the choice of law has been negotiated with undue luck, might interpret this as an indication that neither of the parties wish to have their contract regulated by the other party’s national law. It has been claimed that the tendency to interpret the parties silence as a negative choice is more common in cases relating to disputes where one of the parties is a state agency.¹⁷⁸

¹⁷⁷ ICC Case no 7110, ICC International Court of Arbitration Bulletin Vol. 10 No. 2, 1999

¹⁷⁸ Mayer, *The Role of the UNIDROIT Principles in ICC Arbitration Practice*(2002)

In a partial award rendered by the ICC regarding the determination of substantial law, the tribunal decided on the UNIDROIT Principles as the governing law under the same considerations as the previous award.¹⁷⁹ The dispute arose between a French Company (the licensee) and a Japanese Company (licensor) under which the licensee claimed that its exclusivity within Europe was infringed by a second contract concluded between the licensor and X. The provisions of the contract were not decisive. The licensee claimed French law, whilst the licensor claimed Japanese law should be applied.

After having considered the agreement, which included manufacturing and sales of products in various places of the world, in accordance with both Japanese or French law, the tribunal concluded “*The arbitral tribunal considers that the difficulties to find decisive factors qualifying either Japanese or French law as applicable to the contract reveal the inadequacy of the choice of a domestic legal system to govern a case like this.*” The tribunal then concluded on the applicable law to be those rules of Lex Mercatoria.¹⁸⁰

In a third award¹⁸¹ rendered by the SCC, the tribunal gave a detailed reasoning in the favour of the application of the UNIDROIT Principles. The tribunal was to consider an agreement between a Chinese company and a European company seated in Luxembourg. As the tribunal found that the agreement otherwise appeared as a well prepared and qualified approach to contract drafting, they found it obvious that the parties deliberately refrained from agreeing on the applicable law. This led the tribunal to conclude that the issue was to be based on “*such rules of law that have found their way into international codifications or suchlike that enjoy a widespread recognition among countries involved in international trade.*”¹⁸² In applying the Principles they found to have a wide recognition, the tribunal further affirmed that they: “*offers a protection for contracting parties that*

¹⁷⁹ ICC Case no 9875, ICC International Court of Arbitration Bulletin Vol. 12 No. 2, 2001

¹⁸⁰ ICC Case no 9875, ICC International Court of Arbitration Bulletin Vol. 12 No. 2, 2001

¹⁸¹ SCC Case 117/1999, Separate Arbitral Award rendered in 2001

¹⁸² SCC Case 117/1999, Separate Arbitral Award rendered in 2001

adequately reflects the basic principles of commercial relation in most, if not all developed countries.”¹⁸³

4.3.2 The UNIDROIT Principles as Means of Supplementing National Law

In an increasing number of cases, the UNIDROIT Principles are used as a means of supplementing the national law in order to confirm a solution based on other legal grounds.¹⁸⁴ The dualistic application has taken form through arbitral practice with the effect of giving a transnational status to national law.¹⁸⁵ The Preamble of the Principles also constitutes such an application of them.¹⁸⁶ Although such use of the principles presumes an initial choice by the parties, an examination of the topic might be useful as means of determining the scope of application of the UNIDRIOT Principles.

In a case submitted to the ICC, the arbitrators were to solve a dispute between a Spanish company and an Indian company for the instalment and manufacturing of industrial machinery.¹⁸⁷

According to the provisions of the English law as the parties had chosen to govern their dispute, the award of damages was subject to likelihood and the mitigation of loss. With regards to the mitigation of loss, the arbitrator stated; “*A similar standard has been established internationally, primarily in the Unidroit Principles of International Commercial Contracts (1994) which state in sub-section (1) of article 7.4.8(...)*”¹⁸⁸ After having examined the content of the rule, the arbitrator further affirmed: “*This brings us back to an examination of whether [Defendant] took all reasonable steps to mitigate the*

¹⁸³ SCC Case 117/1999, Separate Arbitral Award rendered in 2001

¹⁸⁴ Marrella, *The UNIDROIT Principles of International Commercial Contracts in ICC Arbitration, 1999-2001*(2001)

¹⁸⁵ Marella, *op.cit*

¹⁸⁶ UNIDROIT Principles of International Commercial Contracts, Preambles, sentence 6

¹⁸⁷ ICC Case no. 9594, ICC International Court of Arbitration Bulletin Vol. 12 No. 2, 1999

¹⁸⁸ ICC Case no. 9594, ICC International Court of Arbitration Bulletin Vol. 12 No. 2, 1999

loss consequent to [Claimant]'s breach of quality/delay.”¹⁸⁹ Accordingly, the merits of the dispute were being considered in the light of Article 7.4.8 of the UNIDROIT Principles.

Using the principles to confirm a reason determined pursuant to national law, may also have other advantages. Applying them might help reassuring any party that may have been opposed to the application of national law, especially in those circumstances where the law applied is that of the other party’s nationality.

In a case submitted to the ICC, the tribunal were to solve a dispute between a manufacturer and a distributor both claiming a termination of the contract due to the other’s default.¹⁹⁰ The relationship was tied in a number of contracts, whereas only one contained of a choice of Italian law to govern the dispute. Before submitting the dispute to arbitration, the parties had entered into a settlement agreement under which the obligations of both parties were laid down. The tribunal found that determining the scope and interpretation of the settlement played an essential role in finding a solution to the issues. The tribunal applied the Italian Law as means of interpreting the settlement and added: “*The rules relating to interpretation and good faith contained in the Unidroit Principles (in particular, Articles 1.7 and from 4.1 to 4.8), which are in all events a useful reference framework for applying and judging a contract of an international nature, also confirm what has been said.*”¹⁹¹

¹⁸⁹ ICC Case no. 9594, ICC International Court of Arbitration Bulletin Vol. 12 No. 2, 1999

¹⁹⁰ ICC Case no. 8908, ICC International Court of Arbitration Bulletin Vol. 10 No. 2, 1999

¹⁹¹ ICC Case no. 8908, ICC International Court of Arbitration Bulletin Vol. 10 No. 2, 1999

5 Conclusions

5.1 Application of Mandatory Rules

While there seem to be a general consensus on the application of mandatory rules deriving from the *lex contractus*, the application of foreign mandatory rules and those of the *lex fori* are met with more scepticism. The main reason for the hesitation to apply mandatory rules other than those governing the contract appears to be the arbitrator's obligation towards the party autonomy. Accordingly, an arbitrator would feel some reluctance in applying mandatory rules that would limit the party autonomy and that the parties could not easily have foreseen. However, as opposed to the supporters of the delocalisation theory and conservative common law countries, the awards presented in the foregoing, indicates a certain respect towards the application of mandatory rules other than those of the *lex contractus*. Pursuant to the aforementioned dualism in arbitration, it appears the main reason is the arbitrator's concerns for the outcome of his award. This seem to be due to the increasing amount of confidence entrusted the arbitration forum by national courts, whereas vital interests of a public law character will also be a stake. Thus, to avoid having their award annulled or deemed non enforceable, it seem like arbitrators are willing to show their respect by considering the mandatory rules and public policy protecting such vital interests.

Conclusively, it might be this dualism that should be evaluated in the event a question of application of mandatory rules of the *situs* or a third country arises.

Pursuant to the question of the application of mandatory rules it should be maintained that the requirement for application appears to be that the rules are characterized as overriding. While some provisions, such as the Rome I Regulation expressly states that its rules concerning e.g. consumer protection should be considered overriding, other rules, not consisting of any such wording, would be subject to a more detailed evaluation as to their characterization.¹⁹² Initially, mandatory rules and public policy represent two different aspects of a state's interests, by reference to the awards presented above, arbitrators seem

¹⁹² See footnote 14

to treat them equally. This appears to be due to the overlapping between the two set of rules, whereas they both represent the vital interest of a state. It is thus important to emphasize that public policy represents the unwritten interests of a state that are directly applicable and if not respected, might give ground for a refusal of the award. Both the text and the awards seem to indicate this.

There seem to be several approaches taken on by arbitrators in applying mandatory rules of a foreign state. While some arbitrators prefer to act as they were judges and accordingly apply all rules they find to be overriding, others prefer to make the evaluation in accordance with the rules connected to the dispute, and thus only apply those rules that might affect the outcome of their award. Furthermore, other arbitrators prefer to apply mandatory rules under general contractual terms such as force majeure or illegality clauses. The existence of a transnational public policy might in certain events excuse the application of foreign mandatory rules. Being a part of those rules usually means that the arbitrators would be obliged to apply them and that the parties could have foreseen them. It appears that even arbitrators showing reluctance towards the application of foreign rules, would respect transnational public policy.

5.2 The Absence of a Choice on Substantive Law

By reference what is presented in the foregoing there seem to be several different approaches chosen by the arbitrators in determining the governing law. While the application of the private international system of the situs appears to have been abandoned, awards show that the rules of the seat might be applied e.g. in the event the parties have expressly chosen that place. The latter is thus part of the arbitrators choice on approaches provided for by several arbitration rules, under which they may apply the conflict rules they deem appropriate or that has the closest connection with the dispute.¹⁹³ However, on the

¹⁹³ See for example: article 28 of UNCITRAL Model Law, article 4 of the Rome Convention and article 187 of the Switzerland's Federal Code on Private International Law.

basis of arbitration rules providing for a direct application of substantive law, arbitrators may also take on the approach of determining the governing law without going by the conflict of law rules.¹⁹⁴ The latter is called the direct approach and in accordance with what is discussed in the foregoing, the most modern approach chosen by arbitrators.

The rules governing arbitration today seem to either provide for the application of conflict of law rules which the arbitrator deem appropriate, hereunder the close connection test, or the direct application of substantive rules. Under the first, arbitrators will have to apply a certain conflict of law rule of a private international system, but they are not obliged to apply the whole private international system of a state, (as used to be the criteria under the application of conflict rules of the seat). Under the direct application, arbitrators may abandon the “middle-step” of applying a conflict of law rule, and apply the substantive law directly. Nevertheless, on the basis of the two awards presented under the discussion on the direct approach, it seems that some arbitrators still prefer to make the conflict rule considerations when determining the applicable law.¹⁹⁵ The difference appears to lie in the fact that they are not obliged to make the decision using a particular conflict of law rule.

In determining the scope of the arbitrator’s freedom it is on one hand concluded that the choice of substantive law itself does not give ground for a refusal of the award. On the other hand, however, the freedom in applying a rule other than national law might be determined by the procedural rules governing the arbitration. As seen above, the wording of the concerned rules, whether they provide for the application of “law” or “rules of law”, might limit the scope of application. Thus, arbitrators in favour of applying general principles of law, and thus abandoning the private international law, would have to give concern to the rules from which their power derive. Nevertheless, should an arbitrator have that right, he would still have to give consideration to those mandatory rules mentioned above, and that might inflict the arbitration due to their connection to the dispute.

¹⁹⁴ See for example: Article 17 of the ICC Rules of Arbitration, article 22 of the SCC Rules of Arbitration and article 1496 of the French Code of Civil Procedure.

¹⁹⁵ See point 3.8.1, case no 9415 and 10/2005

Conclusively, these rules might also impose some limitations to the arbitrator's freedom.

As seen above, the provisions allowing the arbitrators to apply "rules of law" has in some cases lead to the application of general principles and hereunder the UNIDROIT Principles. Applying UNIDROIT Principles as the governing law where the parties have not made a choice of law seem to have gained a wider acceptance among arbitrators as presented through the awards examined in the foregoing, and has also been confirmed through authors of arbitration.¹⁹⁶ This might derive from the fact that on the basis of their content which extracts a clear manifest body of rules interpreted through increasing case law, the principles are easily interpreted.¹⁹⁷ It appears that the UNIDROIT Principles would best be applied under the circumstances where the case is clearly international and neither of the involved parties are willing to submit to the national law of the other. This is expressly stated in two of the awards above.¹⁹⁸

By means of highlighting the arbitrators approach towards general principles, an ICC Award rendered in 1995 will be presented.¹⁹⁹ This award provides a good illustration of arbitrators considering the transnational rules to be best fit to meet the legitimate expectations in international transaction. In its decision the tribunal stated that it would apply; "the law that best accords with the need of the international commercial community, which is not in conflict with the reasonable expectations of the parties, that produces uniformity of results, and that provides for a reasonable solution of the issue."²⁰⁰ The tribunal further affirms that "the application of international standards offers many

¹⁹⁶ See for example: Bernadini, *International Arbitration and A-National Rules of Law*(2004) and Marella, *The UNIDROIT Principles of International Commercial Contracts in ICC Arbitration 1999-2001*(2001)

¹⁹⁷ D.M. Lew, *The UNIDROIT Principles as Lex Contractus, With or Without an Explicit or Tacit Choice of Law: An Arbitrator's Perspective*(2002)

¹⁹⁸ See ICC Case no 7110 and SCC Case no 117/1999 under point 4.3.1

¹⁹⁹ ICC Case no 8385, referred to by Derains, *Role of the UNIDROIT Principles in International Commercial Arbitration (1): A European Perspective*(2002), point 17

²⁰⁰ ICC Case no 8385, referred to by Derains, *op.cit.*, point 17

advantages. They apply uniformly and are not dependent on the peculiarities of any particular national law. They take due account of the needs of international intercourse and permit cross-fertilization between systems that may be unduly wedded to conceptual distinctions and those that look for a pragmatic and fair resolution in the individual case. This area therefore offers an ideal opportunity for applying what is increasingly called *lex mercatoria*.”²⁰¹

Even though this might indicate a clear trend, an examination of the other awards under which the conflict rules are applied, makes it more uncertain. It appears that several arbitrators are still in favour of applying the conflict of law rules, which is also confirmed through the existence of the arbitration rules presented above.

It should be mentioned that in all events, the best way for the arbitrator to be able to meet the legitimate expectations of the parties, is for them to insert a choice-of-law clause in their contract.

²⁰¹ ICC Case no 8385, referred to by Derains, *op.cit*, point 17

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6.5 Court Decisions

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ABBREVIATIONS

ICC	International Chamber of Commerce
SCC	Stockholm Chamber of Commerce
The Rome Convention	EC Convention on the Law Applicable to Contractual Obligations
Rome 1 Regulation	Regulation of the European Parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations